STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**05/16/06**	Bill No:	**SB 1458**
Tax:	**Pseudoephedrine Fee**	Author:	**Simitian**
Related Bills:	**SB 421 (Simitian)**		

This analysis will only address the bill's provisions that impact the Board.

BILL SUMMARY

Among other things, this bill would require the State Board of Equalization (Board) to:

- Register each person that manufactures pseudoephedrine in this state or who imports pseudoephedrine into this state and charge a fee to each registrant to cover the administrative costs in maintaining the list of registrants.
- Collect a fee from each person who manufactures pseudoephedrine in this state or who imports pseudoephedrine into this state, based on the number of milligrams of pseudoephedrine manufactured in or imported into this state by that person.
- Determine whether a product containing pseudoephedrine is exempt from the fee.

Summary of Amendments

Since the previous analysis, this bill was amended to allocate funds to the Board for startup and continuing administrative costs.

ANALYSIS

Current Law

Under existing Sales and Use Tax Law, all retail sales of tangible personal property are subject to sales tax unless specifically exempted by law. For example, Section 6369 of the Revenue and Taxation Code (Section) provides that prescription medicines sold or furnished by licensed medical personnel are not subject to tax.

Retail sales of controlled substances are currently subject to sales tax. Unregistered sellers of methamphetamine and other illicit drugs who fail to collect and remit sales tax are in violation of the sales tax law. A number of police departments regularly contact the Board when they make arrests for possession of controlled substances with intent to sell. In order for the Board to levy an assessment, documentation of sales must be available, and assets must be accessible to permit collection of the tax due.

Under the California Uniform Controlled Substance Act, specifically section 11100 of the Health and Safety Code, any manufacturer, wholesaler, retailer, or other person or entity in this state that sells, transfers, or otherwise furnishes pseudoephedrine to any person or entity in this state or any other state is required to submit a report to the DOJ of all of those transactions.

Section 11100 of the Health and Safety Code also requires any manufacturer, wholesaler, retailer, or other person or entity in this state to obtain, prior to selling,

transferring, or otherwise furnishing pseudoephedrine to any person or business entity in this state or any other state:

- A letter of authorization from that person or business entity that includes the currently valid business license number or federal Drug Enforcement Administration registration number, the address of the business, and a full description of how the substance is to be used, and
- Proper identification from the purchaser.

As provided in Section 11100, these reporting requirements do not apply to any sale, transfer, furnishing, or receipt of any product that contains pseudoephedrine which is lawfully sold, transferred, or furnished over the counter without a prescription pursuant to the federal Food, Drug, and Cosmetic Act or regulations adopted thereunder. However, this exclusion does not apply to preparations in solid or liquid dosage form, except pediatric liquid forms, as defined, containing pseudoephedrine, where the individual transaction involves more than three packages or nine grams of pseudoephedrine.

Section 11100 of the Health and Safety Code further provides that it is unlawful for any retail distributor to sell in a single transaction more than three packages of a product that he or she knows to contain pseudoephedrine or to knowingly sell more than nine grams of pseudoephedrine, other than pediatric liquids as defined. Except as otherwise provided, the three-package-per-transaction limitation or nine-gram-per-transaction limitation applies to any product that is lawfully sold, transferred, or furnished over-the-counter without a prescription pursuant to the federal Food, Drug, and Cosmetic Act or regulations adopted thereunder, unless otherwise exempted.

As provided in the California Uniform Controlled Substances Act, the DOJ established and maintains a Bureau of Narcotic Enforcement (BNE). The BNE operates a Clandestine Laboratory Enforcement Program (CLEP) which investigates and closes illegal drug-making operations. The CLEP works in conjunction with the Precursor Compliance Program (PCP) which operates from the BNE headquarters. The PCP tracks chemicals shipped into California that are likely to be bought by illegal drug makers. The PCP also follows the use of methamphetamine-making products such as reagents, solvents, laboratory glass flasks and precursor chemicals that are needed for illegal drug making.

Proposed Law

This bill would add Article 7.3 (commencing with section 25383) to Chapter 6.8 of Division 20 of the Health and Safety Code to establish the Illegal Drug Lab Waste Cleanup Act. Among other things, this bill would require the Board to register and receive quarterly reports from persons that manufacture pseudoephedrine in this state or who import pseudoephedrine into this state. Additionally, the Board would be required to perform certain administrative functions, including, but not limited to, the following: registration, verification of quarterly reports, collection of fee, issuance of determinations including penalties, and refunds.

Department of Toxic Substances Control (DTSC)

The DTSC would be required to set the amount of the fee “upon the first manufacturing or importation of pseudoephedrine in this state by a manufacturer or importer” on or

before September 1, 2007, and on or before September 1 annually thereafter. The fee would be set at an amount sufficient to fund the annual work plan for taking removal or remedial action to clean up drug lab waste, but in an amount of not more than .0232 cent ($0.000232) per milligram of pseudoephedrine.

This fee would be imposed upon the "first manufacturing or importation of pseudoephedrine in this state." This bill would require the Board to collect the fee from each registrant on and after September 1, 2007. This is a non-urgency bill and would take effect January 1, 2007. The fee revenues collected would be deposited in the Illegal Drug Lab Cleanup Subaccount, which this bill would create in the Toxic Substances Control Account in the General Fund, for expenditure, upon appropriation by the Legislature, solely for the following purposes:

- To pay for all of the costs of the Board to administer the article, including collecting and making refunds associated with the collection of the fee imposed.
- To pay for refunds of the fee.
- To provide funding to the DTSC to take removal and remedial actions to clean up drug lab waste.

The DTSC would be allowed to expend the funds authorized for expenditure by entering into a contract with a city or county to take or oversee removal or remedial actions to clean up drug lab waste.

Board of Equalization

Under this bill, a person who manufactures pseudoephedrine in this state or who imports pseudoephedrine into this state would be required to register with the Board. The registration requirement would not apply to a person who imports less than an unspecified amount of pseudoephedrine into this state during a calendar year and who does not manufacture any pseudoephedrine in this state. A person would be prohibited from selling or distributing any product containing pseudoephedrine in the state if the product is received or purchased from a manufacturer or importer who is not registered in accordance with the requirements of this bill.

A registrant would be required to file a quarterly report with the Board, due on the last day of the month following each quarterly period. All of the following information must be included in the quarterly report:

- The name, address, and telephone number of the person required to register.
- The number of milligrams of pseudoephedrine the person manufactured in this state during that quarterly reporting period.
- The number of milligrams of pseudoephedrine the person imported into this state during that quarterly reporting period.
- The number of milligrams of pseudoephedrine the person sold, transferred, or otherwise furnished to other persons in this state during that quarterly reporting period.
- Any other information the Board deems necessary.

The Board would be required to maintain the list of registrants electronically, where feasible, and to make the list available to law enforcement agencies throughout the state where necessary for a legitimate state purpose, including, but not limited to, fee collection and criminal investigation. The Board would charge a fee to each registrant sufficient to cover the costs incurred in maintaining the list of registrants, including administrative costs.

This bill would require the Board to calculate, bill, and collect a fee from persons that manufacture pseudoephedrine in this state or who import pseudoephedrine into this state, based upon information contained in the quarterly report. The Board may exempt a product containing pseudoephedrine from the fee if the Board determines the presence of pseudoephedrine in that product is not feasibly available for use in the production of methamphetamine.

To collect the fee, the Board would mail each registrant a notice of determination (bill). Each notice of determination would contain the amount of the person's fee, as calculated based on the information contained in the person's quarterly report. The fee would be calculated by multiplying the established rate by "the number of milligrams of pseudoephedrine manufactured in this state or imported into this state" by a manufacturer or importer, irregardless of whether the pseudoephedrine was "first" manufactured or "first" imported into the state by the manufacturer or importer. The fee imposed would be due and payable 30 days after the Board mails a notice of determination.

The Board would collect the fee in accordance with the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code), except that the bill provides a separate process for refunds and for resolving disputed registration or reporting requirements. The Fee Collection Procedures Law contains "generic" administrative provisions for the administration and collection of fee programs to be administered by the Board; except that this bill provides that the Board would be unable to consider petitions for redetermination and claims for refund under the Fee Collections Procedures Law.

If the Board determines that a person who is required to register has failed to register or failed to file a correct quarterly report, the Board may register that person, prepare and file a correct quarterly report, and mail a copy of that quarterly report to that person. If a person who receives a quarterly report prepared by the Board disagrees with the quarterly report, the person would be required to notify the Board and specifically identify the areas of disagreement in writing within 60 days after the date the Board mailed the quarterly report to the person.

Upon receiving a notice of disagreement, the Board would do all of the following:

- Investigate each area of disagreement.
- Mail a responsive letter to the person who submitted the notice of disagreement addressing each area of disagreement.
- Revise the quarterly report as necessary.

Unless the Board receives a timely notice of disagreement, the Board would issue a notice of determination based on the information in the registration and the quarterly report. However, if a timely notice of disagreement is received, the Board would,

investigate the registrant's basis for its disagreement, issue a notice addressing each area of disagreement, and revise the quarterly report, if necessary, before determining whether to impose a penalty and issuing a notice of determination. The Board would impose, but not be authorized to relieve, any of the following civil penalties:

- A penalty equal to 10 percent of a person's quarterly fee for each failure of the person to file a correct and timely quarterly report, as required.
- A penalty equal to 25 percent of a person's quarterly fee for each failure by a person to file a correct and timely quarterly report after being notified by the Board, as provided, that the person previously has failed to file a correct and timely quarterly report.
- A penalty equal to 50 percent of a person's fee for each failure to file a correct and timely quarterly report with the intent to evade the fee imposed or to defraud the state.

A registrant may also amend a quarterly report filed with the Board any time prior to one year from its due date. If an amendment to a quarterly report would require an increase or decrease in the amount of the fee owed by that person, the Board would issue a supplemental notice to assess the increased amount or to issue a refund for the decreased amount.

Violations

A person who fails to properly register with the Board is subject to a civil penalty in an amount not to exceed ten thousand dollars ($10,000). A person who is a retailer or distributor, who receives or purchases a product containing pseudoephedrine intended for sale in the state from a manufacturer or importer who is not registered, is subject to a civil penalty in an amount not to exceed ten thousand dollars ($10,000).

All civil penalties assessed and collected would be deposited into the Environmental Enforcement and Training Account, and the revenues would be available for expenditure pursuant to Title 13 (commencing with section 14300) of Part 4 of the Penal Code (*Local Environmental Enforcement and Training Programs*).

In General

Methamphetamine, a derivative of amphetamine, is a powerful stimulant that affects the central nervous system. Amphetamines, which were originally intended for use in nasal decongestants and bronchial inhalers and have limited medical applications, including the treatment of narcolepsy, weight control, and attention deficit disorder, can be easily manufactured in clandestine laboratories (meth labs) using ingredients purchased in local stores. Over-the-counter cold medicines containing ephedrine or **pseudoephedrine** and other materials are "cooked" in meth labs to make methamphetamine.

The manufacture of methamphetamine has a severe impact on the environment. The production of one pound of methamphetamine releases poisonous gases into the atmosphere and creates 5 to 7 pounds of toxic waste. Many laboratory operators dump the toxic waste down household drains, in fields and yards, or on rural roads.

Methamphetamine labs can be portable and so are easily dismantled, stored, or moved. This portability helps methamphetamine manufacturers avoid law enforcement

authorities. These labs have been found in many different types of locations, including apartments, hotel rooms, rented storage spaces, and trucks.[1]

Background

In 1997, Senate Bill 560 (Hayden) was introduced to impose a 25% sales and use tax on the retail cash sales of chemicals used as reagents in the manufacturing of methamphetamine. The funds collected would have been used primarily for drug rehabilitation programs. That bill advanced all the way to the Assembly Floor, where it failed to receive the necessary two-thirds votes for passage.

In 1999, a proposal identical to Senate Bill 560 was introduced in Assembly Bill 306 (Corbett). That bill died in the Senate Committee on Appropriations.

This year, Senate Bill 421 (Simitian) was amended to include the DOJ, DTSC and the Board as the administrative agencies before it was held in the Senate Appropriations Committee.

Recent changes in federal law affect California retailers of all nonprescription pseudoephedrine, ephedrine, and phenylpropanolamine products. Title VII of Public Law 109-177 went into effect March 9, 2006 (with other specified effective dates) as The Combat Methamphetamine Epidemic Act of 2005. In general, all nonprescription items containing pseudoephedrine, ephedrine, and phenylpropanolamine are now classified as "schedule listed chemical products" under the federal Controlled Substances Act. The changes now affect gel caps, liquids, and pediatric products. Retailer requirements include some of the following: products containing ephedrine and pseudoephedrine must be kept behind the counter or in a locked case; require purchasers to show proper identification and sign a sales log; and restrict purchases to no more than 3.6 grams per day and 9 grams per month per customer. The National Association of Chain Drug Stores is advising its members that although there is no preemption of state or local laws, if there is a conflict between a provision of federal law and a state or local law, then the most stringent provision must be complied with.

Several other provisions were enacted with The Combat Methamphetamine Epidemic Act of 2005, including but not limited to the following: imposes quotas on manufacturers and importers of ephedrine and pseudoephedrine; increases the government's authority to monitor the transfers of precursor chemicals from foreign manufacturers; extends existing penalties to cover illegal imports or exports of precursor chemicals; and clarifies that any person convicted of a methamphetamine-related offense can be held liable for cleanup costs of methamphetamine labs.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to revise the funding mechanism to cleanup drug lab waste. The DTSC has completed emergency cleanups of over 15,000 methamphetamine labs in the past 10 years. The actions involved in the removal are done to protect the public health and safety and the environment from the release, or threatened release, of hazardous substances. The DTSC is responsible for this portion of the cleanup, which is financed by the General Fund.

[1] http://www.whitehousedrugpolicy.gov/publications/factsht/methamph/

2. **The May 16, 2006 amendments** provides that a loan, of an unspecified amount, will be made from the General Fund to the Illegal Drug Lab Cleanup Subaccount to fund the startup costs incurred by the Board. The loan would be repaid to the General Fund from the proceeds derived from the pseudoephedrine fee. Ongoing administrative costs would be covered by appropriations from the Illegal Drug Lab Cleanup Subaccount. **The April 20, 2006 amendments** required the Board to perform activities previously required of the DOJ. These duties include, but are not limited to: (a) registering each person that manufactures pseudoephedrine in this state or who imports pseudoephedrine into this state; (b) maintaining a list of such registrants and charging a fee to cover the administrative costs in maintaining the list; (c) processing quarterly reports filed with the Board; (d) determining which persons are required to file a quarterly report and whether the information in the quarterly report is correct; (e) determining whether a product containing pseudoephedrine is exempt from the fee; (f) issuing refunds; and (g) assessing the specified civil penalties, <u>without</u> the ability to provide relief from such penalties. The **April 17, 2006 amendments** allowed the DOJ to exempt a product containing pseudoephedrine from the fee if the DOJ determined that the presence of pseudoephedrine in that product is not feasibly available for use in the production of methamphetamine.

3. **There are several issues that would make this bill very problematic to administer.** First, the bill requires manufacturers and importers to report to a second agency, unnecessarily. As noted above, pseudoephedrine manufacturers and importers are already required to file reports with the DOJ regarding their sales of pseudoephedrine pursuant to Health and Safety Code section 11100. This bill would require the same persons to register and file similar reports with the Board for no apparent reason.

   Second, the bill requires the Board to undertake duties the DOJ is better equipped to perform and thereby imposes unnecessary costs on the Board. The bill requires the Board to analyze and determine the chemical composition of substances to determine whether they are pseudoephedrine, and requires the Board to analyze products containing pseudoephedrine to determine whether the presence of pseudoephedrine in those products is "feasibly available for use in the production of methamphetamine." The Board does not have a laboratory nor does it have staff trained in analyzing the chemical composition of substances or products. However, the DOJ does have a laboratory and staff trained in analyzing the chemical composition of substances. Therefore, the bill imposes unnecessary costs on the Board to build a laboratory and train staff to analyze the chemical composition of substances, or obtain laboratory services from a third party, which would not be incurred if this function were administered by the DOJ.

   Third, the bill makes the Board responsible for tracking the manufacture and distribution of pseudoephedrine throughout the state in a manner that it is not equipped to handle, and that is not efficient for California's state and local law enforcement agencies. The reporting provisions of this bill could provide a clear map of the pseudoephedrine manufacturing and distribution chain in California and thereby enable California to better enforce the laws applicable to sales of pseudoephedrine and prevent the manufacture and sale of methamphetamine within the state. However, the responsibility for administering the reporting requirements is placed with an agency that does not administer any of the laws applicable to

transfers of pseudoephedrine, or any of the criminal laws applicable to the manufacture and sale of methamphetamine. As such, the Board is less likely to spot pseudoephedrine reporting issues that would be important to a law enforcement agency trying to prevent the manufacture and sale of methamphetamine, such as the DOJ; and the arrangement will impose unnecessary administrative costs on the state as law enforcement agencies, such as the DOJ, continually request information from the Board, and Board staff responds to the requests.

Fourth, the entire Fee Collection Procedures Law should be applicable to the Board's administration of the pseudoephedrine fee, if the Board continues to be responsible for determining the correctness of registrants' reports. As previously explained, the Board utilizes the Fee Collection Procedures Law to uniformly administer and collect Board administered fees. The bill currently makes the provisions of the Fee Collection Procedures Law that apply to petitions for redetermination and claims for refund inapplicable to the Board's administration of the pseudoephedrine fee. The exemptions were originally necessary because the petition for redetermination and claim for refund procedures applicable to the pseudoephedrine fee were to be administered by the DOJ, which does not have any authority to enforce the Fee Collections Procedures Law and would be better served by implementing its own, more streamlined, review procedures. However, the bill was amended to make the Board responsible for processing petitions for redetermination and claims for refund so the Board's procedures for reviewing such petitions and claims should be uniform with that of other Board administered fees, as was the legislative intent for enacting the Fee Collection Procedures Law.

Fifth, the language used to impose the fee is problematic to administer because it requires the Board to track the first manufacturing and first importation of pseudoephedrine in this state. The Board does not have any expertise regarding the processes for manufacturing pseudoephedrine and therefore does not understand the significance of the language imposing the fee on the first manufacture of pseudoephedrine in this state. Also, the Board will have to verify whether or not every importation of pseudoephedrine into the state is the first such importation of the same pseudoephedrine. This will require the Board to obtain a lot more information to determine the application of the fee to each importation of pseudoephedrine and also require registrants to obtain and maintain such information for reporting and potential audits. These two problems could be remedied by simply imposing the fee on all sales of pseudoephedrine in this state by a manufacturer or importer.

Sixth, there are substantial inconsistencies in the bill between the provisions for imposition of the fee and the provisions for the reporting of information and collection of the fee. One part of the bill directs the DTSC to set the amount of the fee on "the first manufacturing or importation of pseudoephedrine in this state." However, the reporting requirements do not require registrants to report their first manufacturing or first importation of pseudoephedrine, and the fee calculation provisions of the bill direct the Board to calculate the fee by multiplying the rate set by the DTSC by the amount of pseudoephedrine a registrant "manufactured or imported into the state," without regard to whether such amounts are first manufactured or first imported. Therefore, these three sets of provisions need to be brought into conformity with each other, and the best way to do this is to amend the imposition and calculation provisions of the bill so that they impose the fee on all sales of pseudoephedrine in

this state by a manufacturer or importer, and calculate the fee based upon the milligrams of pseudoephedrine sold by a manufacturer or importer in this state during the reporting period.

Seventh, the bill should clarify the Board's responsibilities related to the storage and security of chemical substances and the coordination of information between DOJ, BOE, registrants, and other law enforcement agencies.

Eighth, the concerns raised in the first analysis regarding the inconsistency in the language defining "importers" and "manufacturers" have not been addressed.

Board staff is available to work with the author's staff in drafting amendments to the bill.

4. **The fee would impact legitimate users.** Assuming that the term "pseudoephedrine" includes nonprescription medicines, such as Sudafed and Sinutab, which contain pseudoephedrine, and assuming that manufacturers and importers increase the selling price of pseudoephedrine products to reimburse themselves for the fee, the proposed fee would fall upon products purchased by legitimate users. Additionally, the Board's costs to maintain the list of registrants may be significant and the fee charged to each registrant may ultimately be made part of the cost of the product.

5. **This bill could increase state and local sales and use tax revenues.** In order to be reimbursed for the fees, pseudoephedrine manufacturers and importers may increase the price of pseudoephedrine products, which would be reflected in the retail sales price of pseudoephedrine sold to the ultimate consumer.

   Sales and use tax is due based on the gross receipts or sales price of tangible personal property in this state. Since the proposed pseudoephedrine fee would not be specifically excluded from gross receipts or sales price, it would be included in the amount on which sales or use tax is computed.

6. **Legal challenges of any new fee program might be made on the grounds that the fee is a tax.** In July 1997, the California Supreme Court held in *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal.4th 866 that the Childhood Lead Poisoning Prevention Act of 1991 imposed bona fide regulatory fees and not taxes requiring a two-thirds vote of the Legislature under Proposition 13. In summary, the Court found that while the Act did not directly regulate by conferring a specific benefit on, or granting a privilege to, those who pay the fee, it nevertheless imposed regulatory fees under the police power by requiring manufacturers and others whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating those products' adverse health effects.

   Although this measure has been keyed by the Legislative Counsel as a majority vote bill, opponents of this measure might question whether the surcharge imposed is in legal effect "taxes" required to be enacted by a two-thirds vote of the Legislature.

COST ESTIMATE

The Board would incur non-absorbable costs to analyze and determine the chemical composition of substances that it is not currently equipped or staffed to determine. Additional non-absorbable costs would be related to the tracking of pseudoephedrine throughout the state in a manner that the Board is not currently equipped to handle.

Compared to the introduced version of the bill, the implementation and administration costs for the Board would be significantly higher. A detailed cost estimate of this workload is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The BNE conducted a review of the various distributors and manufacturers that provided pseudoephedrine products to the California retail market during calendar year 2004. Total adult and pediatric consumption of over-the-counter (OTC) products (solid and liquid) was provided in a briefing report titled "2004 Pseudoephedrine OTCs and Methamphetamine Related Issues." Actual consumption data for pills and liquid capsules of pseudoephedrine was provided in pounds (lbs). The liquid data was only provided in gallons and, for the purpose of this estimate, had to be converted to pounds.

The report indicated 1.9 billion pills (199,180 lbs of pseudoephedrine) and 209 million liquid caps (16,019 lbs of pseudoephedrine) were consumed by adults, totaling 215,199 lbs of pseudoephedrine. Since the liquid data was in gallons (259,336 gallons), we converted gallons to equivalent pounds by extrapolating it from the data provided. We estimated the 259,336 gallons would yield 12,167 lbs of pseudoephedrine. The total quantity of adult pseudoephedrine amounts to 227,336 pounds (215,199 + 12,167). Each pound of pseudoephedrine is equivalent to 453,592 milligrams. Therefore, total pounds converts to 103.1 billion milligrams (227,336 lbs × 453,592 = 103.1 billion milligrams) of adult pseudoephedrine. For pediatrics (solid and liquid), the total amount consumed was estimated to be 584 million milligrams. Total pseudoephedrine consumption is estimated to be 103.7 billion milligrams (103.1 billion + .584 billion).

Revenue Summary

Based on the proposed maximum fee of $0.000232 per milligram of pseudoephedrine, an estimated $24 million in fee revenues could be generated annually ($0.000232 ×103.7 billion milligrams = $24 million) for deposit in the Illegal Drug Lab Cleanup Subaccount, which this bill would create in the Toxic Substances Control Account in the General Fund.

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